The Mergers & Acquisitions Advisor

Issues, Trends and Strategies for Successful Mergers and Acquisitions

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Strategic Alliances Chosen over Acquisitions as Principal Means of Corporate Growth

Over Eighty Percent of Chief Executives Look Toward Strategic Alliances to Solidify the Deals

The Whys and Hows of Doing Strategic Alliances

Strategic alliances, in all their vast structures, are everywhere these days. In the past two years, 20,000 alliances have been formed worldwide; from third-party entities known as joint ventures to two (or more) companies partnered to leverage a wide array of resources including technology, branding, know-how, market infiltration and so forth. In contrast, there were only approximately 2,000 merger and acquisition transactions in the past two years.

"Alliances already account for anywhere between 6 percent and 15 percent of the market value of a typical company; ... the future looks even more alliance-intensive," **Andersen Consulting's** Charles Kalmback, Jr. and Charles Roussel state in *Outlook Magazine*. "Our work shows that 82 percent of executives believe alliances will be a prime vehicle for future growth," they continue. And according to the *Wall Street Journal*, eighty percent of CEOs believe alliances will be a principal means of corporate growth.

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High Failure Rates of M&A Cited

One of the reasons cited for the growth of strategic alliances over the past two years is the high rate of failure for M&A transactions. **Booz-Allen & Hamilton's** John Harbison, Albert Viscio and Amy Asin report in *Making Acquisitions Work: Capturing Value After the Deal* that fewer than half of 1998's worldwide $2.5 trillion deals will succeed. There are any number of reasons why these failures occur, but before rushing into a "ready, aim, fire" M&A transaction—whether you are dealing in small, middle or large markets—you might want to consider the successful alternative: that of a strategic alliance. Or, given that M&A bankers overlook strategic alliances, it might be worthwhile to consider the positive elements associated with an alliance to help inform your more permanent deals.

How a Strategic Alliance Helped Restaurateurs Become More Successful

Consider the dual-branding alliance between franchise restaurateurs, **Dunkin' Donuts** and **Baskin-Robbins**, for instance.

Continued on page 5

A Mergers & Acquisitions Advisor Exclusive:

Always Look in the Backyard:
Conducting Cost-Effective Environmental Due Diligence in Corporate Mergers and Acquisitions

By Larry Schnapf

Environmental due diligence continues to play an increasingly important role in corporate mergers and acquisitions. Unfortunately, contracting parties often fail to do sufficient environmental due diligence or do not complete it early enough to use effectively the information in the transaction. As a result, parties may find themselves saddled with unexpected liabilities. This article discusses how to tailor a due diligence program to a particular transaction and how to use the information in a way that will bring maximum value to the transaction.

1. The Importance of Environmental Due Diligence

Federal and state environmental laws can impose significant liabilities on a wide range of corporate entities includ-

Continued on page 3

Inside The Mergers & Acquisitions Advisor

STRATEGIC ALLIANCES CHOSEN OVER ACQUISITIONS

Continued from page 1

Many restaurants have done the same thing due, in part, to the proliferation of food courts throughout the country. Customers began to expect more choices. Although Dunkin' Donuts and Baskin-Robbins joined to eventually improve customer service by giving customers complete menu choices (two-for-one concept), the alliance was driven by profit. Cohabitating, the two separate but equal partners leverage locale and customer buying-time resources. However, though the alliance might have been profit driven, the companies are savvy enough to realize they have to focus on providing high quality customer service in order to keep driving the profits up.

What has made this particular doughnut and ice-cream alliance successful for both partners were a number elements:

1) Both offer successful products on their own. This is very important because you do not want to try to create a dual brand if one partner is having difficulty generating enough volume or traffic. Trying to lift one company out of a morass by attaching another's good name can end up tanking both brands;
2) Dunkin' Donuts and Baskin-Robbins offer complementary, not competing products and services. Their peak hours differ (morning and night) and their products are well-known to customers and therefore easy to add to menus;
3) Dunkin' Donuts and Baskin-Robbins found in each other a partner who shared the same brand quality. This is often as vital in strategic alliances as it is in an M&A transaction, and has to do with the first element of success mentioned above; and
4) The two cultures mesh – there was a willingness on the partners to truly cohabitate, which of course is another vital element to consider in and M&A transaction, as well.

How an Alliance Changed the Automobile Industry

Another significant example of the nature of a successful alliance can be found in **General Motors** [NYSE:GM] and **Toyota's** relationship. The two companies have been allied with each other for many years on many levels, not the least of which is in infiltrating the other's country (that's why the whole "Buy America" issue is almost laughable).

> **WHEN TO CONSIDER A STRATEGIC ALLIANCE**
>
> As a mergers and acquisitions professional, sometimes an alliance makes more sense for you. Consider a strategic alliance over a more permanent transaction when you want to create the following:
>
> - A less permanent partnership and/or more immediate results
> - Dual brand recognition
> - To leverage capabilities
> - To create a third-party entity
> - To infiltrate another market

These two car company giants have leveraged their capabilities in strategic alliances, and they have also invested in establishing a separate entity in their New United Motor Manufacturing, Inc. in Fremont, California. A separate entity in this regard, or a joint venture, is a kind of sub-set of a strategic alliance. The joint venture of two or more partners has the *specific goals of creating a "third" party company with an independent identity from both partners and of presenting a new brand in the marketplace.* At **New United Motor Manufacturing, Inc.,** a Toyota/General Motors joint venture in Fremont, California, 4,400 U.S. workers build Corollas and Tacoma compact pickup trucks for Toyota and Geo Prizms for General Motors, leveraging one another's technology and expertise.

One Arm Washes the Other in the Financial Industry

> To educate itself on electronic stock sales and banking and establish an online presence and capability, Goldman Sachs purchased stock and warrants representing 22% of Wit Capital, an Internet Investment Bank.

A strategic alliance is not always the endpoint of the relationship, meaning that a savvy strategic alliance can often pave the way to an M&A transaction. Consider the win/win alliance between **Goldman Sachs** [NYSE:GS] and **Wit Capital Corporation**, for example, which occurred in March of this year.

Wit Capital, one of the first Internet investment banking firms, focuses on offering and selling securities through the Internet to online individual investors. Although not an exclusive agreement, the two companies joined to collaborate on initial public offerings, and in particular, affinity programs for issuing clients. To educate itself on electronic stock sales and banking, and establish an online presence and capability, Goldman purchased stock and warrants representing 22% of Wit Capital. The alliance allows Wit to offer IPO shares direct to its customers at insider prices, through the cooperation of Goldman, which offers some IPO shares direct to the public through Wit Capital.

When Wit Capital went public shortly thereafter, Goldman's alliance took on an obvious added value; if, at some point, Goldman and Wit decide that an M&A is an appropriate course of action, their pre-established relationship has set the tone for a successful transaction. Last month, Wit Capital announced the acquisition of **Soundview Technology, Inc.**, an investment banking firm specializing in the high technology industry. No doubt, Goldman influenced the transaction.

A Smart Alliance in High Technology

Dorothy Langer, president of **Langer and Company** in Boston, Massachusetts, is an expert consultant in both strategic alliances and M&A transactions. Some mergers are winners, Langer notes, because their design is more like alliances with

Continued on next page

STRATEGIC ALLIANCES CHOSEN OVER ACQUISITIONS

Continued from page 5

regard to motivation. She has seen precisely the influence smart alliances can have on a company that later buys or merges with another.

Along with **Lotus Development Corporation's** first-ever former vice president of strategic alliances, Hemang Davé, Langer helped the company veer away from building alliances based on how to look good fast for the marketplace. Instead, the approach was "from the ground up" with a focus on the long-term. Langer helped set the stage for Lotus to establish more than 10,000 partnerships with—and this is infinitely important—*the tools and training to support them.* The alliances were so successful, in fact, as Davé stated in *The Alliance Analyst* 1995 issue, "that one of our partners, **IBM Corporation** [NYSE:IBM], decided to pay a big premium to acquire us."

The Soul of an Alliance

Although strategic alliances may make more sense than an M&A transaction, consider that *The Wall Street Journal* reported "a staggering 61% of alliances have failed or are plagued by under-performance." So when approaching your M&A transactions, or pondering whether a strategic alliance can meet your needs while saving you from having to plunk down enormous capital or sacrifice identity, Langer has identified and explored in-depth the soul of an alliance and how it differs from the essence of an M&A transaction. She has touched upon today's universally accepted elements and differentiations, as noted by various experts in the industry, but has phrased them in a unique and concise manner.

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ATTRIBUTES OF SMART STRATEGIC ALLIANCES

- Complementary goals, not competitive goals
- Immediate profit is not always the goal, leaving room for creative, well thought out solutions
- Narrow goals equal narrow focus and effective efforts
- Narrow focus directs effective due diligence
- Cultures tend to be matched well, without the tension of worrying who's culture is going to domineer
- Enlightened self-interest, rather than jockeying for position, allows for freedom of focus on goals

Source: "Lessons M&A Experts Can Learn from Strategic Alliances" by Dorothy Langer

To briefly summarize from Langer's paper "*Lessons M&A Experts Can Learn From Strategic Alliances*," the six key defining characteristics of alliances versus M&A transactions are as follows:

From the start of an alliance negotiation, the companies are involved in a process of mutual and friendly discovery.

1) win/win environment as opposed to outright hostility;

2) complementing/leveraging resources before focusing on immediate financial gain;

3) narrowly focused objectives to deliver clear value versus too broad strokes of goals without clear vision for what happens after the contract is signed;

4) clear, narrowly defined goals allow for precise due diligence as opposed to the "big picture" obscuring the vital details of the deal;

5) tolerance, as a result of the impermanent nature of the deal, for partners' various cultures versus forced submission of one identity to another;

6) all levels of partnership focused on achieving goals rather than splintered or shattered focus as a result of executive infighting or mass layoff tensions.

1) Win/Win Attitude

In any number of alliance structures there tends to be an innate "win/win attitude" and friendly environment in which participants can work to build their new partnership. Potential partners are more likely to come to the table prepared to examine objectively and discover how best their resources can be leveraged than in a potential M&A deal. From the start of an alliance negotiation, the companies are involved in a process of mutual and friendly discovery: How can we help ourselves while helping you? This is in direct contrast to mergers and acquisitions, which can often occur under conditions of outright one-sidedness and hostility. Langer sums up the overall discrepancy as "...the difference between a marriage based on love and a shotgun wedding..."

In alliances, the financial gain is not necessarily the primary goal.

2) Complement and Leverage

Second among Langer's findings is that in alliances the financial gain is not necessarily the primary goal. Of course, it is

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a definite goal of the partnership. Yet, the primary motivation stems from a need to "complement and leverage" each partner's resources. For instance, a software developer and manufacturer needs the distribution arm of Lotus or Microsoft and the distributor needs the new technology; two airlines, one from the United States and the other from Sweden, combine efforts to sell each other's seats, or two competitor airlines combine their frequent flyer plans. These are win/win situations, with financial gain certainly part of the plan, but not the primary plan.

Langer has observed that in an M&A transaction often the parties are more focused on results than the process and "fail to leverage the synergy of their resources"; thereby potentially sabotaging that initial goal of financial gain. With so much at stake in mergers, it is worthwhile to consider how your company can complement and leverage another company's resources *along with* deriving financial gain—eventually.

In *Making Acquisitions Work*, Booz-Hamilton notes that many companies go through buying spurts, particularly when an industry is consolidating as with financial institutions, supermarkets, real estate and so forth. But, as the authors point out, "without a real vision for what the [companies] will do once they have finished the acquisition binge..." the threat of failure due to this undeveloped post-merger integration vision lurks around the corner. Similarly, as Langer declares in her article, "objective-setting [in mergers] may be done so broadly that no single goal receives enough attention to achieve the potential synergy."

3) Clear Value

Because the process of establishing an alliance involves focusing on very narrow goals, that process enables an alliance to "deliver clear value": We know we want to try to combine efforts to help one another out, but to do what? Is our main goal to block a competitor? If so, what will we do five years down the line if that competitor is no longer an issue? Will we continue to leverage other resources from each other? Is there a plan B in place? Is there detailed vision? Furthermore, if a partnership starts off with a narrow focus and succeeds in its endeavor, it is more likely to succeed when it finally does broaden its objectives to empower the relationship with new ventures.

Culture clashing can be eliminated or mitigated in alliances.

STRATEGIC ALLIANCE SOURCES

For more information about strategic alliances, consult the following sources:

- *www.langerco.com*—Dorothy Langer, Langer and Company
- *Institutionalizing Alliance Skills: Secrets of Repeatable Success* by John R. Harbison and Peter Pekar, Jr.
- *www.allianceanalyst.com*
- *www.smartalliances.com* ⌘

4) Where to do Due Diligence

Fourth among Langer's noted top six alliance attributes is that if potential partners have very narrow goals, they will "instantly know where to direct due diligence efforts." Conversely, in an M&A transaction, the bigger the picture, the more risk there is that players will overlook vital specifics linked to how well the company will run once it's merged.

Without [a] power struggle tearing at the very fabric of the deal, the partnership is "free to focus" on how to meet the established goals from the beginning on through fruition.

5) Impermanence Breeds Tolerance

Next on Langer's list is the fact that culture clashing can be eliminated or mitigated in alliances. Because an alliance implies "temporary," if two potential partners discover cultural contrasts that threaten their objectives, they can learn to "tolerate those differences because they aren't partnering permanently," says Langer. An "open-ended" commitment often allows for creative, flexible solutions otherwise not explored or even thought of when the contract is exclusive and permanently binding.

In M&A transactions, however, often the buyer forces the acquired company to give up its identity for the parent, and that force of will can lead to big trouble. Although "work" implies impersonal ("get over it"), as opposed to "home" or "play," people's instincts are the same no matter what environment they're in (the need for survival, success, belonging, etc.). It might sound "touchy-feely" but reflecting on how your work force will or will not integrate is critical before signing the papers. If a domineering company is going to force its will/identity on its new acquisition, you have to consider whether the merged company is flexible enough to bend or whether its culture is rigidly opposed and will break, wreaking havoc throughout the new entity.

6) Freedom of Focus

Similarly, with an alliance, although there are numerous financial structures a deal can have, the model is less like a marriage (built on trust and patience) and more like a diplomatic relationship, driven by enlightened self-interest. With this approach of enlightened self-interest, "[m]ass layoffs and executive infighting about who will stay and who will go are not part of the alliance model," says Langer. Without that power struggle tearing at the very fabric of the deal, the partnership is "free to focus" on how to meet the established goals from the beginning on through fruition.

Although there is, of course, no guarantee for a successful deal, there are definite pitfalls that can be avoided by establishing a robust foundation on which success is built. ⌘